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No. 06-43

In the Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. AND MOTOROLA, INC.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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QUESTION PRESENTED

Whether this Court should imply a private cause of action under Section 10(b) of the Securities Exchange Act against vendors whose transactions with a publicly traded company were improperly accounted for by the public company in its financial statements, when the plaintiff—an investor in the public company—did not rely on the transactions or on any statement by the vendors, and the vendors did not use or employ a deceptive device in connection with the purchase or sale of a security.

RULES 14.1(B) AND 29.6 STATEMENT

All parties to the proceeding in the Eighth Circuit are identified in the caption.

The corporate disclosure statements of Motorola, Inc. and Scientific-Atlanta, Inc. are set forth in their briefs in opposition to certiorari.

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STATEMENT

Plaintiff alleges that defendants Motorola, Inc. and Scientific-Atlanta, Inc. (the "Vendors") entered into separate transactions to sell electronic equipment to their customer Charter Communications, Inc. ("Charter"). It further alleges that the Vendors knew or should have known that Charter would account for these transactions improperly in order to inflate its financial results. According to plaintiff's own allegations, Charter's mischaracterization of the Vendors' transactions was an immaterially small part of a long-running fraud by Charter that affected virtually every aspect of its operations and that led Charter, upon disclosure of its misstatements, to lose billions of dollars in stock market value.

The Vendors accounted for the transactions correctly, recording no net gain. They dealt only with Charter, which alone was fully aware of the facts. They had no involvement in the preparation or review of Charter's financial statements, and they made no statements to Charter's investors or accountants and had no duty to do so. Nothing in Charter's public financial statements or other announcements to investors identified the transactions with the Vendors. Plaintiff does not allege that any investor knew of Charter's transactions with the Vendors, let alone relied on them or on any statement by the Vendors when trading Charter securities.

The Eighth Circuit correctly held that plaintiff's allegations amount at most to a claim that the Vendors aided and abetted Charter's fraud—a claim barred by *Central Bank* v. *First Interstate Bank*, 511 U.S. 164 (1994). Plaintiff contends that this suit should proceed because the Vendors engaged in deceptive conduct as part of a "scheme to defraud." That expansive theory of liability would gut *Central Bank*, turning product manufacturers who do business with a customer into "primary violators" potentially liable for unlimited market losses suffered by *the customer's* investors. The result here would be that Motorola and Scientific-Atlanta shareholders

would have to compensate Charter shareholders *for a fraud committed by Charter's own management.*

By labeling a transaction as a "sham," the "scheme" theory would impose upon anyone doing business with a public company legal responsibility for that company's financial reporting. This would leave vendors in the United States and abroad—as well as other commercial partners, lenders, accountants, and lawyers—open to Section 10(b) class action liabilities so disproportionate to any business they might have conducted that irresistible pressure to settle even meritless claims would result.

Plaintiff's "scheme" liability theory would negate *Central Bank's* requirement that a plaintiff establish reliance, an element "critical for recovery under 10b-5," on a defendant-by-defendant basis. 511 U.S. at 180. It also conflicts with the plain language of Section 10(b), which requires that the defendant itself must have used or employed a deceptive device in connection with the purchase or sale of a security. None of those elements is satisfied here. And it contradicts Congress's deliberate policy decision in Section 20(e), 15 U.S.C. § 78t(e), a provision added by the Private Securities Litigation Reform Act (PSLRA) that gave the SEC broad powers over secondary actors while *rejecting* efforts to create a private cause of action for these claims.

The "implied" cause of action plaintiff asks this Court to create is wholly untethered. No guidance as to its contours is found in the express provisions of the securities laws creating secondary liability. And the federal courts would have to engage in a massive round of common law policy-making to determine how reliance, materiality, and loss causation, among other elements, apply to scheme allegations against remote contributors to a fraud—contentious issues that would have to be resolved to flesh out this far-reaching new implied cause of action. Such issues, as the Eighth Circuit held, should be left to Congress.

A. The Statutory And Regulatory Background.

This Court held in *Central Bank* that Section 10(b) and Rule 10b-5 do not create liability for aiding and abetting securities fraud. The Court concluded that Section 10(b) "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act" and confirmed that plaintiffs "may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b)." 511 U.S. at 173, 177. A "secondary actor"—such as "a lawyer, accountant, or bank"—that "employs a manipulative device or makes a material misstatement (or omission) *on which a purchaser or seller of securities relies* may be liable as a primary violator under 10b-5," but only if "*all* of the requirements for primary liability under Rule 10b-5 are met." *Id.* at 191 (second emphasis in original).

A year after *Central Bank*, Congress in the PSLRA restored SEC enforcement authority over aiders and abettors, but refused to allow private parties to bring such suits. Section 20(e), 15 U.S.C. § 78t(e), entitled "Prosecution of persons who aid and abet violations," establishes that in an action brought by the SEC "any person that knowingly provides substantial assistance" to a primary violator "shall be deemed to be in violation of [the Exchange Act] to the same extent as the person to whom such assistance is provided."

Congress deliberately left intact *Central Bank's* prohibition of aiding and abetting claims by private plaintiffs. The SEC had argued that Congress should "restore the aiding and abetting liability eliminated in" *Central Bank*. S. Rep. No. 104-98, at 48 (1995). SEC Chairman Arthur Levitt testified that the decision "does away with claims against a whole class of defendants"; he warned that those "whose assistance or acquiescence may have been necessary to the fraud, or who may have been acting behind the scenes, but who did not themselves directly make statements that were relied upon by investors, may escape any liability to private parties"

under *Central Bank*.[1] Congress rejected the SEC's proposal. The Senate Report explained that authorizing "private aiding and abetting liability actions under Section 10(b) would be contrary to [the PSLRA's] goal of reducing meritless securities litigation." S. Rep. No. 104-98, at 19.

Congress revisited the issue again in 2002 when it considered the Sarbanes-Oxley Act. Some legislators argued in favor of amending the 1934 Act to subject aiders and abettors to private suits. *E.g.*, H.R. Rep. No. 107-414, at 54 (2002); 148 Cong. Rec. S6584 (daily ed. July 10, 2002). But although the statute enabled the SEC to distribute administrative recoveries to investors and modified the limitations period governing private lawsuits (15 U.S.C. §§ 1658, 7246), it did *not* extend private civil liability to aiders and abettors.

B. The Vendors' Transactions With Charter.

1. Scientific-Atlanta and Motorola manufacture cable boxes and sell them to cable television providers like Charter, which install them in subscribers' homes. AC ¶¶ 22, 34-35, 75.[2] These "set-top" boxes enable subscribers to access cable television programming and other services. Pet. App. 36a.

Plaintiff alleges that the Vendors are liable under Section 10(b) for engaging in business transactions with Charter, which Charter later accounted for improperly in its financial statements. In these transactions, plaintiff asserts, Charter agreed to pay the Vendors an additional $20 for each set-top

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[1] *Abandonment of the Private Right of Action for Aiding and Abetting Sec. Fraud: Hearing before the Subcomm. on Sec. of the Sen. Comm. on Banking, Hous., & Urb. Aff.*, 103d Cong. 82, 83 (1994).

[2] The Amended Class Action Complaint ("AC") is reproduced in the appendix to Scientific-Atlanta's Brief in Opposition. That complaint was the subject of the district court's ruling on the Vendors' motions to dismiss. As we explain (p. 11, *infra*), the district court denied leave to file the Second Amended Complaint reproduced in the joint appendix.

box purchased during the fourth quarter of 2000 (six percent of the $350 price of a box).[3] The Vendors, in turn, agreed to pay Charter the same amount to support Charter's advertising of digital cable services and equipment. AC ¶¶ 76-77.

Plaintiff alleges that these transactions were proposed by Charter, an important customer of the Vendors, to enable Charter to cover a revenue shortfall. AC ¶¶ 75-80; Pet. Br. 5-6.[4] Plaintiff labels these transactions "kickback arrangements" and a "sham." AC ¶¶ 7, 76-77. But plaintiff does not dispute that the Vendors delivered set-top boxes to Charter, or that the Vendors paid Charter for advertising. Nor does plaintiff allege that no advertising was prepared or aired.

2. As the district court explained, "[i]n 2000, the digital set-top was a relatively new product, and cable operators such as Charter marketed its new features to prospective and existing cable customers." Pet. App. 36a. Advertising agreements were common among cable operators, who wanted new subscribers, and equipment suppliers, whose sales were driven by subscriber growth. See CA Br. of Appellee Scientific-Atlanta 7; AC ¶ 146. More generally, "reciprocal dealing" such as cooperative advertising is recognized as a "useful business practice" for companies "entering into a major contract for products or services." *Teachers' Ret. Sys.* v. *Hunter*, 477 F.3d 162, 178 (4th Cir. 2007).

Plaintiff acknowledges (AC ¶ 80) that there were legitimate methods of accounting for reciprocal marketing transactions. But a host of accounting issues confronted an

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[3] Compl. ¶ 9, *SEC* v. *Scientific-Atlanta, Inc.*, No. 06 Civ. 4823 (S.D.N.Y.), *available at* http://tinyurl.com/3chwzw.

[4] The SEC's cease-and-desist order against Charter likewise states that "*Charter* devised a scheme to get advertising business from its digital set-top box suppliers." *In re Charter Commc'ns, Inc.*, Exchange Act Release No. 50,098, at ¶ 13 (July 27, 2004) (emphasis added), *available at* http://tinyurl.com/2nzsfs.

equipment buyer engaged in such a transaction. In 2000, the Financial Accounting Standards Board had just begun to consider the complex questions involved. The Board saw the vendor's and the customer's accounting obligations as separate matters—with no suggestion that an equipment seller should be held responsible for the buyer's choice of how to account for the transaction. And it had not yet issued specific guidance regarding the treatment each party should use.[5]

3. Charter consulted its auditor, Arthur Andersen, regarding how Charter should account for the transactions with the Vendors. AC ¶ 80. Andersen allegedly advised Charter that it should not recognize the Vendors' payments as advertising revenue because "they appeared integrally related to the cost increases being paid by Charter." *Ibid.* Andersen said Charter could recognize the advertising fees as revenues only if the set-top box payments and advertising fees were at fair market value, unrelated, and negotiated at least a month apart. *Ibid.* The complaint alleges that a Charter executive told Andersen "that Charter would fulfill those conditions," but later "falsely told Arthur Andersen that the advertising and supply contracts" had been "negotiated by two separate departments at Charter a month apart." *Ibid.* The complaint thus asserts that *Charter* misled Andersen regarding the relationship between the transactions and overstated its earnings by immediately recognizing the advertising payments as revenue while capitalizing the added cost of the set-top boxes and depreciating it over time. AC ¶¶ 7, 80. The complaint does not allege that the Vendors were aware that Charter was misleading its auditors.

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[5] See *Accounting for Consideration Given by a Vendor to a Customer*, Emerging Issues Task Force, Issue No. 01-9 (FASB 2001), *available at* http://tinyurl.com/2qb9x2; *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*, Emerging Issues Task Force, Issue No. 02-16 (FASB 2002), *available at* http://tinyurl.com/2mhej8.

Plaintiff does not dispute, moreover, that the Vendors' own accounting for the transactions was proper. The Vendors appropriately booked the sales proceeds as revenue and the advertising payments as an offset to revenue—which had no net impact on their financial statements. See CA Br. of Appellee Scientific-Atlanta 7.

C. Plaintiff Seeks To Hold The Vendors Liable For Charter's Multi-Faceted Scheme To Defraud.

1. Plaintiff filed a putative class action on behalf of Charter's stockholders, making claims under Section 10(b) against Charter, Charter executives, Arthur Andersen, and the Vendors. Plaintiff's Amended Complaint, at issue here, alleges that from November 1999 to July 2002 Charter engaged in a "multi-prong scheme" to inflate revenues and cash flow. AC ¶¶ 8-9. Plaintiff asserts that Charter misrepresented its financial position to investors by falsely doubling its actual growth rate (AC ¶ 4), improperly capitalizing $145 million in labor costs (¶¶ 6, 64e), and improperly deferring $59 million in marketing expenses (¶ 64h), resulting in overstating operating cash flow (¶ 71). A restatement by Charter of its financial reports issued in April 2003 indicated that Charter's operating cash flow had been inflated by $292 million in 2001 and $195 million in 2000, for a total of $487 million. AC ¶ 15.

Plaintiff also alleged that Charter inflated its internal customer growth rate by delaying disconnection for non-paying customers (AC ¶ 5), double-counting and misclassifying subscribers (¶ 53d-e), and making up fictitious subscriber accounts (¶ 55). Plaintiff asserts that Charter's false announcement that it achieved the best customer growth rate in the industry was especially important to analysts and the market. AC ¶¶ 49-51.

Plaintiff states that these practices inflated Charter's stock price to a class-period high of $26.31 per share. AC ¶ 10. Following disclosure of the initiation of a criminal investigation, Charter's stock price fell to $3.50 in July 2002

and $0.76 in October 2002. AC ¶ 16, 147. With 295 million shares outstanding, Charter's loss of market value from its stock price high to its October low exceeded $7 billion. Charter executives ultimately were indicted and convicted for a broad range of misconduct. The SEC also issued a cease-and-desist order against Charter.

In contrast to the massive size and broad scope of Charter's fraud, plaintiff alleges that Charter's improper accounting for *both* Vendors' advertising payments inflated Charter's operating cash flow *for a single quarter by $17 million, i.e., only 3.5% of the total inflation alleged.* AC ¶ 79. Yet plaintiff seeks to hold the Vendors liable for Charter's *entire loss of common stock value.* AC ¶¶ 196-197 (alleging that Vendors acted knowingly or recklessly); see 15 U.S.C. § 78u-4(f)(2)(A) (joint and several liability for knowing violations of the securities laws).

2. Charter's fraudulent accounting practices relating to its own financial statements are at the heart of plaintiff's claims. AC ¶¶ 78-80. But plaintiff does not allege that the Vendors had any control over the financial reporting of Charter, an independent company, or that they "played any role in preparing or disseminating the fraudulent financial statements and press releases through which Charter published its deception to analysts and investors." Pet. App. 4a.

Instead, plaintiff baldly asserts that the Vendors knew or recklessly disregarded Charter's intent to use the transactions to inflate its reported revenue. AC ¶ 196. The only allegation offered to support this assertion is that the set-top box contracts "were back dated to August 2000 on the instructions" of Charter executives to give the "appearance that the set-top box price agreements were negotiated a month before the advertising contracts which were dated in late September." AC ¶ 80. But the complaint alleges that it was *Charter* that used inaccurate characterizations of the transactions to satisfy its accountants. *Ibid.* The complaint does not claim that anything

the Vendors did deceived their counter-party, Charter, or that the Vendors ever provided information to Charter's accountants or any Charter shareholder.

Moreover, although plaintiff alleges that Charter's fraud inflated total earnings (AC ¶ 79), it does not claim that Charter's financial statements disclosed the transactions, or Charter's accounting treatment of them, or any statements or conduct by the Vendors.[6] Plaintiff pleads no facts showing that it or other investors were even aware of the contracts at issue, still less that their decision to purchase or sell Charter's stock was influenced by the existence of these contracts or the immaterial amount of revenue they generated for Charter.

In its brief to this Court plaintiff now asserts (at 6-9) that the Vendors agreed to help Charter deceive its accountants. But the Amended Complaint alleges no particular facts giving rise to a strong inference that the Vendors had such an intent or any facts suggesting that such an agreement existed. See 15 U.S.C. § 78u-4(b)(2). The extra-record material cited by plaintiff shows the opposite. The indictment of Charter's senior executives states that they falsely told their employee who negotiated with the Vendors "that Arthur Andersen had approved the transaction[s]." The executives told him how to document the transactions and he relayed that instruction to the Vendors.[7] Plaintiff pleaded no facts showing that the Vendors knew Charter's executives were deceiving Andersen, let alone that the Vendors intended to help them do so.[8]

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[6] The Form 10-K cited by amici Ohio *et al.* (at 6 n.5) does *not* mention the transactions. See http://tinyurl.com/yrogg6.

[7] *United States* v. *Barford*, No. 4:03CR00434, ¶¶ 22-23 (E.D. Mo. July 24, 2003), *available at* http://tinyurl.com/2pwrwk.

[8] Plaintiff relies (at 11) on SEC proceedings involving a different cable provider, Adelphia. But the SEC in *Adelphia* did not seek to hold the Vendors primarily liable for Adelphia's fraud (as plaintiff does here). Instead, it charged Scientific-Atlanta with aiding and

D. The District Court Dismissed Plaintiff's Complaint Based On *Central Bank*.

The district court granted the Vendors' motions to dismiss. The court held that plaintiff's claims were "for aiding and abetting liability" and thus were "barred by the Supreme Court's decision in *Central Bank*." Pet. App. 39a. The court found that plaintiff's Amended Complaint

- "do[es] not assert that [Vendors] made any statement, omission or action at issue or that plaintiffs relied on any statement, omission or action made by [Vendors]";
- "do[es] not allege that [Vendors] were responsible for" or "involved with the preparation of Charter's allegedly false or misleading financial statements," its "improper internal accounting practices," or the "false or misleading public statements" made by Charter, or that they "even knew of * * * Charter's accounting treatment";
- "do[es] not allege that any of [Charter's false statements] were made, seen, or reviewed by [Vendors]"; and
- "ha[s] not alleged that [Vendors] had any duty to Charter's investors." Pet. App. 41a, 46a.

Instead, plaintiff contended that the Vendors were liable to Charter's investors because "they engaged in a business transaction that Charter purportedly improperly accounted for." Pet. App. 41a. The court found no precedent for that contention and applied the general principle that a plaintiff's "'[r]eliance only on representations made by another cannot itself form the basis of liability'" after *Central Bank*. *Id.* at

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abetting Adelphia and sought a cease-and-desist order against Motorola. These charges were settled without admission or denial of the SEC's allegations. See Compl. ¶¶ 45, 49, *SEC* v. *Scientific-Atlanta, supra, available at* http://tinyurl.com/3chwzw; *In re Motorola, Inc.*, Exchange Act Release No. 55,725 (May 8, 2007), *available at* http://tinyurl.com/2qovcj.

40a. In this Court, plaintiff does not take issue with any of the district court's statements concerning the complaint.

E. The District Court Denied Plaintiff's Motion For Leave To File A Second Amended Complaint.

After dismissal, plaintiff moved for leave to file a Second Amended Complaint (SAC). JA 15a. That complaint, like plaintiff's Amended Complaint, did not allege that the Vendors communicated with Charter's auditors or investors, did not challenge the Vendors' own accounting for the transactions with Charter, and did not allege that no advertising was run (but added allegations that the Vendors paid excessive rates for advertising, SAC ¶ 106).

Plaintiff did more fully allege that the Vendors knew or recklessly disregarded that Charter intended to account for the transactions improperly and to deceive its auditors. The Second Amended Complaint alleged that the Vendors' reckless disregard may be inferred because it is "common knowledge" that equipment purchases are capitalized and that media companies recognize revenue when advertisements are run (SAC ¶¶ 10, 98-100); because Scientific-Atlanta, at Charter's request, sent Charter a letter stating incorrectly that the $20 per box price increase was due to increased manufacturing costs (SAC ¶ 102); and because the Vendors changed the date of the price increase agreements from September to August, as Charter separately requested of each. SAC ¶ 110.

The district court denied leave to amend the complaint. It held that plaintiff's new allegations did nothing to correct the defects identified in the dismissal order, so amendment would be futile. Pet. App. 27a-28a; see *SEC* v. *U.S. Envt'l, Inc.*, 155 F.3d 107, 111 (2d Cir. 1998) (whether a defendant is "a primary violator rather than an aider and abettor turns on the nature of his acts, not on his state of mind").

F. The Court Of Appeals Unanimously Affirmed.

The Eighth Circuit affirmed dismissal of the Amended Complaint. Plaintiff sought to evade *Central Bank*—which involved claims brought under Rule 10b-5*(b)*—by arguing that the Vendors could be held liable as primary violators under Rule 10b-5*(a)* and *(c)*.[9] The Eighth Circuit rejected that tactic, relying on "three governing principles." Pet. App. 8a. First, *Central Bank's* "categorical declaration that a private plaintiff 'may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b)' included claims under Rule 10b-5(a) and (c), as well as Rule 10b-5(b)." Second, "[a] device or contrivance is not 'deceptive,' within the meaning of § 10(b), absent some misstatement or a failure to disclose by one who has a duty to disclose." Third, "[t]he term 'manipulative' in § 10(b) has the limited contextual meaning ascribed in *Santa Fe*," which defined "manipulation" to mean practices "that are intended to mislead investors by artificially affecting market activity." *Ibid.*; *Santa Fe Indus.* v. *Green*, 430 U.S. 462, 476 (1977).

Applying these principles, the Eighth Circuit held that the Vendors could not be liable for "deceptive" conduct because they "did not issue any misstatement relied upon by the investing public, nor were they under a duty to Charter investors and analysts to disclose information useful in evaluating Charter's true financial condition." Pet. App. 10a. Plaintiff thus based its complaint against the Vendors on "nothing more than claims, barred by *Central Bank*, that the Vendors knowingly aided and abetted the Charter defendants in deceiving the investor plaintiffs." *Ibid.* In so holding, the court noted that it was "aware of no case imposing § 10(b) or Rule

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[9] On appeal, plaintiff abandoned its claim that "the Vendors' conduct rose to the level of a misstatement." CA Opening Brief of Plaintiff-Appellant 5 n.3; see AC ¶ 197. Plaintiff's question presented to this Court accordingly assumes that the Vendors made no public misstatements. Pet. i.

10b-5 liability on a business that entered into an arm's length non-securities transaction with an entity that then used the transaction to publish false and misleading statements to its investors and analysts." *Ibid.* The court cautioned that imposing liability under these circumstances "would introduce potentially far-reaching duties and uncertainties for those engaged in day-to-day business dealings," and that such a decision "should be made by Congress." *Ibid.*

Finally, the Eighth Circuit held that the district court did not abuse its discretion in denying plaintiff's motion to amend the complaint. Pet. App. 11a.

INTRODUCTION AND SUMMARY OF ARGUMENT

Prior to *Central Bank* plaintiffs sought to impose liability on defendants whose conduct allegedly facilitated a public company's fraud—but whose conduct was not relied on by investors—by accusing them of "aiding and abetting." After this Court held that Section 10(b) does not create a private cause of action against aiders and abettors, plaintiffs changed the label of their claim to "scheme liability." As every court of appeals to address this question other than the Ninth Circuit has concluded, this subterfuge is barred by *Central Bank*.

Central Bank held that a private damages action for aiding and abetting was precluded for four independent reasons. First, this Court recognized that such an action "would disregard the careful limits on 10b-5 recovery mandated by our earlier cases"—most notably "the reliance requirement." 511 U.S. at 180. Second, aiding and abetting does not fall within "the scope of conduct prohibited by Section 10(b)," as demonstrated by the plain language and structure of the Exchange Act. *Id.* at 172-173. Third, Congress in 1934 "would not have attached aiding and abetting liability to § 10(b) had it provided a private § 10(b) cause of action," as shown by the limitations it imposed on express causes of action it did create. Fourth, "[p]olicy considerations" arising from the uniquely burdensome nature of private securities litigation

confirmed the Court's conclusion. *Id.* at 179, 188-190. Each of these holdings applies equally to scheme liability claims.

First, plaintiff's own theory of the case establishes that its "scheme allegations" cannot satisfy the "critical" reliance requirement. *Central Bank*, 511 U.S. at 180. Under *Central Bank* a private Section 10(b) plaintiff must show reliance on each individual defendant's misstatement or omission. *Ibid.* Plaintiff alleges that it relied on *Charter's* false financial statement, but does not claim that the Vendors made any public misstatement, or owed any duty to Charter investors to speak, or that plaintiff was even aware of the Vendors' conduct. Plaintiff's theory that an investor relies on every action that played a role in facilitating a public company's misrepresentation cannot be reconciled with *Central Bank* and would effectively eliminate the reliance requirement.

When it enacted Section 20(e) in response to *Central Bank*, Congress reaffirmed that the implied damages action does not reach secondary actors who make no statements relied on by investors. Congress granted the SEC authority to obtain relief against those who aid and abet false communications but *rejected* the SEC's request that it restore private aiding and abetting liability for defendants who "did not themselves directly make statements that were relied upon by investors." See pp. 3-4, *supra*. Section 20(e) defines aiding and abetting as "provid[ing] substantial assistance" to a primary violator—precisely what the Vendors are accused of here.

Second, the language and structure of the 1934 Act confirm that Congress did not intend to turn product suppliers, who do not speak to investors, into watchdogs for the accounting practices of public companies. The conduct alleged does not satisfy the plain language of Section 10(b) because the Vendors did not "use or employ" a "deceptive device" "in connection with" the purchase or sale of a security. Charter, not the Vendors, "used or employed" deception in communi-

cating with investors. And because there was no nexus between the Vendors' alleged conduct and plaintiff's trading in Charter securities, that conduct was not "in connection with" securities trading.

Third, the Court's interpretation of private Section 10(b) actions has been guided by the express causes of action in the securities laws. Those express private actions preclude scheme liability, as does Congress's explicit provision for liability for secondary actors, which is limited to "control persons." Extending the implied private right of action to cover secondary actors would not only disregard this express statutory language, but also would necessitate rewriting the requirements of reliance, materiality, and loss causation, forcing courts to engage in extensive lawmaking.

Finally, policy considerations regarded by this Court as important in prior Section 10(b) decisions require rejection of scheme liability. Extending liability to secondary actors with a remote connection to the fraud—through a nebulous "purpose and effect" test that makes it impossible to obtain dismissal—would invite abuse. Pressure on secondary actors to settle would be magnified by rules that make knowing violators responsible for the entire fraud. Investors would be harmed as suppliers, lenders, and professionals declined service or increased prices to compensate for increased risk.

Implied private suits are unnecessary to deter secondary actors from participating in a public company's fraud or to compensate investors. Section 20(e) empowers the SEC to punish aiders and abettors with civil penalties and to use disgorgement to compensate investors. Criminal prosecution by the Department of Justice and state officials further deters involvement in fraud. Affirmance here will sustain Congress's policy judgment that private plaintiffs should not be allowed to impose aiding and abetting liability, a judgment they may not evade simply by changing the label of their claim to "scheme liability."

ARGUMENT

I. LIABILITY IS PRECLUDED IN THIS CASE BY *CENTRAL BANK'S* RELIANCE REQUIREMENT, THE LANGUAGE OF EXCHANGE ACT SECTIONS 10(b) AND 20(e), AND ESTABLISHED LIMITS ON JUDICIALLY IMPLIED CAUSES OF ACTION.

Central Bank drew a bright line between "giving aid to a person who commits" a deceptive practice, which is not actionable in a private damages suit under Section 10(b), and committing deceptive practices in connection with the purchase or sale of a security, which does fall within Section 10(b)'s proscription provided *all* the elements of liability are met. 511 U.S. at 177-178. In dismissing plaintiff's complaint the Eighth Circuit properly held that the Vendors could not be liable for using or employing a "deceptive act" in connection with the purchase or sale of a security because they "did not issue any misstatement relied upon by the investing public, nor were they under a duty to Charter investors and analysts to disclose information useful in evaluating Charter's true financial condition." Pet. App. 10a.

Plaintiff acknowledges that the Vendors "made no public statements concerning [the] transactions" at issue. Pet. Br. i; see Pl. C.A. Br. 5 n.3 (abandoning claim that "Vendors' conduct rose to the level of a misstatement"); Pet. App. 10a. Plaintiff has not alleged that Vendors owed a duty of disclosure to Charter shareholders, which would arise only from a "specific relationship" of "trust and confidence" absent here. Pet. App. 41a; *Central Bank*, 511 U.S. at 180; *Chiarella* v. *United States*, 445 U.S. 222, 233 (1980). And plaintiff has not alleged that the Vendors engaged in manipulation—a "term of art" that refers to illegal trading practices such as "wash sales, matched orders, or rigged prices." *Santa Fe*, 430 U.S. at 476-477. Accordingly, the Eighth Circuit was correct in holding that the test for primary liability in *Central Bank* is

not satisfied. The Vendors were at most aiders and abettors of Charter's fraud.

Plaintiff nevertheless asserts that the Vendors are liable because they engaged in transactions that *Charter* subsequently accounted for improperly after misleading its auditors. Plaintiff alleges that the Vendors independently provided documents *to Charter alone, at Charter's request*, misstating the reason for the set-top box price increase and the date of that increase. According to plaintiff, because these documents were used by Charter to advance its far-reaching scheme to inflate its financial results, the Vendors should be liable for all of Charter investors' losses, even though the Vendors accounted for the transactions properly and Charter's investors did not rely on—indeed were unaware of—the transactions and documents at issue.

Central Bank bars this claim. It makes clear that a private damages action under Section 10(b) is valid only where "*all* of the requirements for primary liability under Rule 10b-5 are met." 511 U.S. at 191. Here, *none* of the requirements for primary liability is satisfied.

A. Scheme Liability Claims Cannot Satisfy Section 10(b)'s Reliance Requirement.

We begin with the question of reliance because that issue was addressed in *Central Bank* in terms that apply directly here. This Court there held that the reliance requirement precludes aiding and abetting liability in private actions. "Were we to allow the aiding and abetting action proposed in this case," the Court stated, "the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions. * * * Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases." 511 U.S. at 180. The absence of that "critical element for recovery" barred aiding and abetting claims. *Ibid.* See *id.* at 191 (defendant may be liable as a primary violator only

when it "makes a material misstatement or omission on which a purchaser or seller of securities relies").

Central Bank thus recognized that a plaintiff "must show reliance on *the defendant's* misstatement or omission to recover under 10b-5." 511 U.S. at 180 (emphasis added); see *Wright* v. *Ernst & Young*, 152 F.3d 169, 175 (2d Cir. 1998) ("'reliance only on representations made by others cannot itself form the basis of liability'"). As then-SEC Chairman Levitt explained, under *Central Bank* a plaintiff "must show, *defendant by defendant*, that the plaintiff reasonably relied on the defendant's misstatement or omission." *Abandonment of the Private Right of Action for Aiding and Abetting Securities Fraud, supra* p. 4 n.1, 103d Cong. 51 (emphasis added). The direct clash between this Court's application of the reliance requirement in *Central Bank* and plaintiff's scheme theory provides an indisputable basis for dismissal.

Here, plaintiff concedes that the Vendors did not communicate with Charter investors and does not allege that investors knew of the transactions at issue, the documents increasing set-top box prices, or any statement made to Charter of the reason for the price increase. Plaintiff's attempt to plead reliance rests on allegations that *Charter* issued false financial statements that reflected commercial transactions that Charter procured to carry out its fraud. See Pet. Br. 39 (arguing that reliance is satisfied by "a prior deceptive act, from which the making of the false statements [to investors] follows as a natural consequence"; the Vendors' conduct "indirectly induce[d] reliance").[10]

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[10] There is a presumption of reliance for "misleading statement[s] by the corporation" issuing a security, based upon the securities laws' "philosophy of full disclosure" by public corporations. *Basic Inc.* v. *Levinson*, 485 U.S. 224, 226, 230, 235 n.12 (1988). But that presumption applies only to statements directed to the market. Here, plaintiff has conceded that the Vendors made *no* such public statement. Moreover, while it accords with "common sense and

The fiction that plaintiffs who rely on a misstatement also rely on the actions of every party alleged to have played some behind-the-scenes role leading up to that misstatement cannot be reconciled with *Central Bank's* holding that plaintiffs must prove they relied on the actions of each individual defendant. Indeed, that fiction would have led to a different result on the facts of *Central Bank* itself. And it would effectively eliminate reliance (or "transaction causation") as a limit on private securities fraud liability, changing it from an inquiry designed to limit liability to those whose actions have caused investors to trade to an open-ended inquiry into whose actions made it possible for a public company to make a misstatement—the very definition of aiding and abetting.

Congress's response to *Central Bank* confirms that Section 10(b) does not authorize private suits against secondary actors who make no statements relied on by investors. The SEC urged Congress to "restore" the aiding and abetting "liability [*Central Bank* had] eliminated," including private liability for damages. S. Rep. No. 104-98, at 48. As we have noted, Chairman Levitt stated that otherwise those who acted "behind the scenes" or "whose assistance or acquiescence may have been necessary to the fraud," but who "did not themselves directly make statements that were relied upon by investors, may escape any liability to private parties." *Supra* p. 4 n.1. Congress rejected the SEC's argument. "[P]rivate aiding and abetting liability actions," the Senate Report explained, "would be contrary to [the PSLRA's] goal of reducing meritless securities litigation." S. Rep. No. 104-98, at 19.

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probability" to presume that an issuer's false denial of merger plans in public statements will affect the price of its stock (*id.* at 246), there is no warrant to presume that conduct of other commercial entities will do so, as *Central Bank* recognizes—even less so conduct that is unknown to investors, engaged in by commercial parties who have no duty of disclosure to those investors.

In enacting Section 20(e) as part of the PSLRA, Congress chose not to write reliance out of private Rule 10b-5 litigation. Refusing to "restore private actions against aiders and abettors," Congress instead granted "the SEC express authority to bring actions seeking injunctive relief or money damages against persons who knowingly aid and abet primary violators of the securities laws"—enforcement actions in which proof of reliance is not required. 4 BROMBERG & LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD § 7:307, at 7-503 (2d ed. 2007). This compromise legislation was designed to *"remov[e] the plaintiffs' class action bar from the equation"* while protecting investors by granting the SEC broad authority over secondary actors. *Id.* § 7:308, at 7-506 (emphasis added). In the Sarbanes-Oxley Act, Congress again rejected entreaties to restore private aiding and abetting liability. See *supra*, p. 4.

The language Congress used in Section 20(e) is telling. Entitled "[p]rosecution of persons who aid and abet violations," the amendment provides that "any person that knowingly *provides substantial assistance* to another person in violation of a provision of this title * * * shall *be deemed to be in violation of such provision* to the same extent as the person to whom such assistance is provided." 15 U.S.C. § 78t(e) (emphasis added). Congress thus equated "persons who aid and abet violations" of Section 10(b) with those who "provid[e] substantial assistance" to a violator. See *INS* v. *National Ctr. for Immigrants' Rights*, 502 U.S. 183, 189 (1991) (reading text and title of provision together). And in finding it necessary to *deem* substantial assistance of a violation of Section 10(b) to be within the SEC's enforcement powers, Congress reaffirmed that the statute would not otherwise reach those who provide substantial assistance. The connection between *Central Bank* and the language of Section 20(e) is clear: *Central Bank* held that there can be no "showing that the plaintiff relied upon [an] aider and abettor's statements or actions" (511 U.S. at 180), and Congress

responded by permitting actions against "persons who aid and abet violations" to be brought only by the SEC, which is not subject to the reliance requirement.

Plaintiff's scheme theory is inconsistent with the plain language of Section 20(e) and frustrates Congress's considered decision to reject private aiding and abetting liability. Congress provided an express SEC-enforced remedy against those who substantially assist a public company's fraud, and "when Congress enacts a specific remedy when no remedy was previously recognized," as occurred in 1995, "the remedy provided is generally regarded as exclusive." *Hinck* v. *United States*, 127 S. Ct. 2011, 2015 (2007); see *EC Term of Years Trust* v. *United States*, 127 S. Ct. 1763, 1767 (2007) ("'a precisely drawn, detailed statute pre-empts more general remedies'"—here, *implied* private remedies); *Alexander* v. *Sandoval*, 532 U.S. 275, 290 (2001) ("[t]he express provision of one method of enforcing a substantive rule suggests that Congress intended to preclude others").

B. Plaintiff's Claim Does Not Fall Within The Scope Of Conduct Prohibited By The Plain Language Of Section 10(b).

Given the absence of any communication between the Vendors and Charter investors and the complete lack of reliance, it is hardly surprising that plaintiff's scheme claim fails to satisfy the statutory language Congress prescribed to place limits on 10(b) liability. *Central Bank* confirmed that, in "cases considering the scope of conduct prohibited by § 10(b) in private suits," this Court has "emphasized adherence to the statutory language." *Central Bank*, 511 U.S. at 173. Here as in *Central Bank* the text of the statute establishes that plaintiff has no implied private right of action.

1. The Vendors did not "use or employ" a "deceptive device" "in connection with" a securities transaction. Plaintiff focuses myopically (at 20-22) on the phrase "deceptive device or contrivance." Its principal argument targets a straw

man: that our position and the court of appeals' holding rest on the principle that spoken or written words are essential to prove a § 10(b) violation. In fact, we do not dispute that communicative conduct—for example, presenting potential investors with a misleading display that makes nonfunctional factory equipment appear operational—*may* amount to a "deceptive device or contrivance."[11]

The particular conduct alleged here—false statements in contracts between the Vendors and Charter—does not qualify as a "deceptive device." See BLACK'S LAW DICTIONARY 528 (3d ed. 1933) ("deceit" is an artifice used "to deceive and trick another, who is ignorant of the true facts"). The alleged scheme to mislead was Charter's, not the Vendors'. The Vendors dealt *only* with Charter, which was not ignorant of the true facts and was not deceived in any way.

The phrase "deceptive device or contrivance," moreover, does not appear in isolation. Section 10(b) does not reach every deceptive device; it prohibits only the use or employment of such devices in connection with the purchase or sale of a security. The Court recently remarked on the importance of statutory terms that, viewed in "context," "limit the reach" of potentially broader phrases. *Dolan* v. *United States Postal Serv.*, 546 U.S. 481, 486-487 (2006); see *Gustafson* v. *Alloyd Co.*, 513 U.S. 561, 575 (1995) ("a word is known by the company it keeps"—a rule that "we rely upon to avoid * * * giving 'unintended breadth to the Acts of Congress'").

"Use" and "employ" are active verbs. "Use" signifies "active employment." *Jones* v. *United States*, 529 U.S. 848,

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[11] References to "misrepresentations," "omissions," and "conduct" in the PSLRA and SLUSA show only that Section 10(b) liability may rest on manipulative conduct or conduct that amounts to an actionable misrepresentation. Contrary to plaintiff's argument (at 21-22), they do not suggest that providing assistance to a primary violator gives rise to a private damages action.

855 (2000); see *Bailey* v. *United States*, 516 U.S. 137, 145 (1995) (the "'ordinary or natural' meaning" of "use" is "'to convert to one's service'" or "'to avail oneself of'"); WEBSTER'S NEW INT'L DICTIONARY 839 (2d ed. 1934) ("employ" is to "make use of, as an instrument, means, or material"). The phrase "use or employ * * * any * * * deceptive device" thus confirms that a party's liability may *not* rest on a deceptive device used or employed by another. Rather, a defendant is liable only if it engaged in the prohibited conduct of using or employing a device to deceive investors.

In ordinary parlance, it cannot be said that A "uses" or "employs" a deceptive device in dealings with B when B is aware of the true facts—as was the case with the transactions here. And if A agrees to assist B in deceiving a third person, C, A still is not using or employing a deceptive device. A's actions can only be understood as facilitating the deception practiced by B—facilitative conduct that *Central Bank* held is not actionable under Section 10(b). See 511 U.S. at 177 (Section 10(b) does not proscribe "giving aid to a person who commits a manipulative or deceptive act").

Section 10(b) also requires that each defendant use or employ a deceptive device "in connection with the purchase or sale" of a security. To find that requirement satisfied here would strip it of any practical meaning and improperly extend the scope of Section 10(b) to "cover the corporate universe." *Santa Fe*, 430 U.S. at 480; see *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 733-734 & n.5 (1975) (the "in connection with" requirement is "badly strained" when construed to cover "the world at large").

In *United States* v. *O'Hagan*, 521 U.S. 642, 652-655 (1997), the Court held that a lawyer violated Section 10(b) by trading securities based on information misappropriated from his client in violation of a duty of trust, deceiving the client by nondisclosure. In holding the "in connection with" requirement satisfied, the Court stressed that the "securities

transaction and the breach of duty * * * coincide": the defendant "use[d] the [misappropriated] information to purchase or sell securities." *Id.* at 656.

In contrast to that inseverable connection, the Court gave an example of a deception that is too "detached from a subsequent securities transaction" to satisfy Section 10(b): when "'a person defrauded a bank into giving him a loan or embezzled cash from another, and then used the proceeds of the misdeed to purchase securities.'" 521 U.S. at 656-657. In those circumstances the "in connection with" requirement "would not be met." *Id.* at 657. The dissenting Justices in *O'Hagan* would have required a closer connection still between the deception and the purchase or sale of a security. 521 U.S. at 679 (Scalia, J., dissenting); *id.* at 685-686 (Thomas, J., and Rehnquist, C.J., dissenting).

Similarly, in *SEC* v. *Zandford*, 535 U.S. 813 (2002), the defendant broker sold a customer's securities in order to convert the proceeds. These sales and fraudulent conversions were not "independent events." *Id.* at 820. Even though there was no "misrepresentation about the value of a particular security," the "in connection with" requirement was satisfied by a failure to disclose where there was a duty to speak that "coincided with the [securities] sales themselves." *Ibid.* The requirement would not, however, be satisfied if, "after a lawful transaction had been consummated, a broker decided to steal the proceeds," or "a thief simply invested the proceeds of a routine conversion in the stock market." *Ibid.* Accord *Merrill Lynch* v. *Dabit*, 547 U.S. 71, 85 (2006) (insisting that "the fraud alleged 'coincide' with a securities transaction—whether by the plaintiff or by someone else").

In each of these cases the trading was integral to the fraud or there was a direct nexus between the deceptive conduct and the trading of securities. The defendant traded on misappropriated information, traded to convert the proceeds to his own use, or disseminated misstatements to investors. But the

standards adopted in these cases make clear that the "in connection with" requirement is *not* met when a defendant's conduct is as remote from securities trading as that alleged here. See *Zoelsch* v. *Arthur Andersen*, 824 F.2d 27, 34-35 (D.C. Cir. 1987) (Bork, J.) (accountant's misleading statements to a foreign affiliate, which used them in preparing a prospectus distributed to investors, were not made "in connection with" securities purchases; the accountant's answers to private inquiries did not "establis[h] any particular relationship with the investing public," and knowledge that its statements "might be used in some later prospectus" was not enough); *Chemical Bank* v. *Arthur Andersen*, 726 F.2d 930, 943-945 (2d Cir. 1984) (Friendly, J.) ("in connection with" not satisfied by accountant's misrepresentations regarding public company that led banks to make loans, even though the banks also obtained stock as security; "'but-for' causation is not enough"); *Rand* v. *Anaconda-Ericsson, Inc.*, 794 F.2d 843, 847-848 (2d Cir. 1986) (Winter, J.) (extending Section 10(b) to conduct "remote from transactions in the market for capital," such as misrepresentations about "a competitor's goods," would produce "a virtually limitless legal theory"); *Taylor* v. *First Union Corp.*, 857 F.2d 240, 245-246 (4th Cir. 1988) (Wilkinson, J.) (rejecting claim where fraud was "tangentially and incidentally related to the sale of plaintiff's stock").

By juxtaposing the active verbs "use or employ" with the "in connection with" requirement, Congress made clear that the defendant's active employment of a deceptive device must be connected to the plaintiff's securities transactions. There is no such coincidence between the Vendors' alleged deceptive acts and plaintiff's trading in Charter securities. Once the Vendors independently supplied Charter with the documents plaintiff says were deceptive, their alleged misconduct was "complete." *O'Hagan*, 521 U.S. at 656. The Vendors accounted for the transactions properly, had no control over Charter's accounting for them, had no contact with

Charter's auditors, made no statements to Charter's investors, and owed those investors no duty of disclosure.

The Vendors' alleged conduct is thus as "detached" from the alleged fraud as any of the examples of inadequate nexus this Court gave in *O'Hagan* and *Zandford*. Plaintiff's bare assertion that the Vendors should have known that their transactions would facilitate Charter's ultimate false statements does not cure this defect. The Court in *O'Hagan* and *Zandford* did not suggest that the outcome of its examples of fraud not "in connection with" buying or selling securities would have been different if there were proof that the defendant planned to use the proceeds to buy stock.

Plaintiff's scheme theory departs radically from settled law. On that theory *any* transaction ultimately taken into account in a public company's financial statements would satisfy the "in connection with" requirement—however many stages and whatever independent conduct intervened. To stretch this statutory requirement to reach vendor conduct so far removed from investors' decisions to trade securities would by "judicial extension" enlarge Section 10(b) "to 'cover the corporate universe,'" contrary to Congress's intent. *Santa Fe*, 430 U.S. 480; see *Marine Bank* v. *Weaver*, 455 U.S. 551, 556 (1982) ("Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud"); see also *Conrail* v. *Gottshall*, 512 U.S. 532, 552-553 (1994) ("Conditioning liability on foreseeability" is "hardly a condition at all").

2. Section 10(b)'s jurisdictional language does not extend liability to secondary actors. Plaintiff makes much (at 19-20) of Section 10(b)'s language providing that it is unlawful, "directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails," to use or employ a deceptive device in connection with a securities transaction. But this Court in *Central Bank* squarely rejected the contention that the term "indirectly" broadens the scope

of section 10(b) liability. 511 U.S. at 176. "[T]here is no support for the proposition that Congress intended the 'directly or indirectly' language to encompass secondary liability." Daniel Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 CAL. L. REV. 80, 94 n.83 (1981). Rather, "[t]he statutory scheme suggests the opposite." *Ibid.* Dean Fischel, whose views this Court relied on in *Central Bank*, explained that the "directly or indirectly" language is part of Section 10(b)'s jurisdictional clause and "allows liability to be imposed upon a defendant" who "does not himself use the jurisdictional means (*i.e.*, mail a letter in interstate commerce)." *Ibid.*; see also 5B ARNOLD JACOBS, DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 8:2, at 8-15 & n.90 (2007) (a defendant "need not personally make use of the mails or interstate commerce; because [of] 10b-5's words 'directly or indirectly,' * * * any use by one defendant is sufficient to implicate others" in "the use of jurisdictional means") (citing cases).

At the time the Exchange Act was passed there was considerable debate regarding the scope of Commerce Clause regulation of securities activity and "prevailing skepticism about the constitutional warrant for federal regulation of stock exchanges." John Hanna, *The Securities Exchange Act of 1934*, 23 CAL. L. REV. 1, 23 (1934). Congress's use of the term "indirectly" sought to reach those who would evade federal regulation by using other persons to perform jurisdictional acts. That intent is confirmed by the placement of the phrase "directly or indirectly" immediately before the clause "by use of any means or instrumentality of interstate commerce." See also 15 U.S.C. §§ 77e(a)-(c), 77q, 78e, 78i(a), 78dd(a). In contrast, the phrase that plaintiff says "indirectly" relates to—"use or employ" a "deceptive device"—occurs two subparts and some 80 words later. See *Jama* v. *Immigration & Customs*, 543 U.S. 335, 343 (2005) (a "'limiting clause or phrase'" modifies "'only'" the phrase it "'immediately follows'").

Where Congress meant the phrase "directly or indirectly" to modify the language prohibiting certain conduct it knew how to say so by placing that phrase immediately before the prohibition. *E.g.*, 15 U.S.C. §§ 78d(a), 78g(c), 78h, 78i(c), 78p(c), 78t(a). For example, the term "directly or indirectly" appears *twice* in Section 9(a)(5)—once before the jurisdictional clause, as in Section 10(b), and again before the prohibition (direct or indirect receipt of consideration to induce purchase of a security at a manipulated price); 15 U.S.C. § 78i(a)(5); see also S. 2693, 73d Cong., § 8(a)(6) (1934).

Because the term "indirectly" modifies only Section 10(b)'s jurisdictional phrase, it cannot be construed to extend liability to secondary actors who engage in a transaction later used by another to defraud investors. That broad reading of "indirectly" would in any event be impermissible, because it would effectively eliminate the "in connection with" and reliance requirements as meaningful constraints on liability. See *United Sav. Ass'n* v. *Timbers of Inwood Forest*, 484 U.S. 365, 375 (1988) (one provision may not be construed to make "a practical nullity" of another).

C. The Structure Of The Securities Laws Confirms That Congress Would Not Have Permitted Private Damages Actions Under Section 10(b) Based On Scheme Liability Claims.

Even if the terms Congress used were not so clear and the incompatibility between scheme liability and the reliance requirement not so obvious, the same result would be required by the structure of the federal securities laws. In interpreting the scope of the *implied* private right of action under Section 10(b), this Court has paid particular attention to both subsequent legislative enactments and the *express* causes of action created in the 1933 and 1934 Acts. See *Central Bank*, 511 U.S. at 178 ("we use the express causes of action in the securities Acts as the primary model for the § 10(b) action").

1. The express private causes of action demonstrate that damages liability does not extend to remote secondary actors. The extraordinarily broad scope of plaintiff's scheme liability theory is starkly inconsistent with Congress's approach in crafting the express causes of action. The scope of each express cause of action is strictly cabined through precise description of the class of persons subject to liability, narrow delineation of the conduct that can give rise to private liability, or both. See *Central Bank*, 511 U.S. at 179. Thus, Section 11(a) of the 1933 Act imposes liability for false registration statements on a limited group of persons who communicate with investors as directors or underwriters, who sign the registration statement, or who express expert opinions in it. 15 U.S.C. § 77k(a). Section 9(e) of the 1934 Act confers a narrow right of action on persons who establish the price impact of carefully defined manipulative practices in stock market trading. *Id.* § 78i(e).

Two express private causes of action are particularly instructive. Section 12 of the 1933 Act reaches any person who "offers or sells a security" by means of a false or misleading prospectus. 15 U.S.C. § 77*l*. This Court in *Pinter* v. *Dahl*, 486 U.S. 622, 642 (1988), recognized that this language imposed liability on "the owner who passed title, or other interest in the security, to the buyer for value." Relying on the statute's definition of the term "offer" to include "solicitation of an offer to buy" (15 U.S.C. § 77b(a)(3)), the Court concluded that Section 12 also reached one "who successfully solicits the purchase." 486 U.S. at 647. But the Court rejected plaintiff's contention, "grounded in tort doctrine," that liability reached anyone "'whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place.'" *Id.* at 649. The Court found no basis for that sweeping approach in the statute and "no congressional intent to incorporate tort law doctrines." *Id.* at 652. The Court also rejected the SEC's argument that those "who 'participate in soliciting the purchase'" should be liable. *Id.* at 651 n.27.

Section 18 of the 1934 Act likewise creates a narrowly drawn claim against any person "who shall make or cause to be made" a false or misleading statement in an SEC filing. To trigger this liability a plaintiff must individually prove that he bought or sold a security "in reliance upon such statement." 15 U.S.C. § 78r(a). The fraud on the market presumption does not apply. *Heit* v. *Weitzen*, 402 F.2d 909, 916 (2d Cir. 1968); *In re Adelphia Commc'ns Corp. Sec. Litig.*, 2005 U.S. Dist. Lexis 43300, at *31 (S.D.N.Y. 2005).

The *Central Bank* bright line rule, applied by the Eighth Circuit here, is consistent with the approach Congress took in creating these express causes of action—closely cabining the scope of liability. By contrast, plaintiff's theory, in which a "purpose and effect" to further an issuer's fraudulent scheme is enough to expose any secondary actor to potentially massive liability, is the same as the "participation" standard rejected in *Pinter*. It would impose liability on an open-ended class of persons for a nebulous category of conduct, an approach Congress did not take *anywhere* in the securities laws. This Court has repeatedly declined to expand implied rights of action under the securities laws beyond the scope of the express remedies. *Central Bank*, 511 U.S. at 180 (it would be "anomalous to impute to Congress an intention in effect to expand the defendant class for 10b-5 actions beyond the bounds delineated for comparable express causes of action"); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 200-201 (1976); *Lampf, Pleva* v. *Gilbertson*, 501 U.S. 350, 359-360 (1991). It should decline to do so again here.

2. Congress did not mean to reach secondary actors who are not "control persons." Plaintiff's broad "scheme liability" approach also conflicts with Congress's carefully limited criteria for imposing secondary liability. Congress expressly dealt with secondary actors in both the 1933 and 1934 Acts and made them liable only to the extent that they "control" the issuer—control that the Vendors lacked over Charter. See 15 U.S.C. §§ 77b(a)(11), 78t(a); 17 C.F.R.

§ 240.12b-2 ("control" means possession of "power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise"). When Congress in Section 20(e) expanded secondary liability to cover aiders and abettors, it did so only for SEC actions, leaving the control person provisions to govern private actions.

"Control person" provisions are the touchstone for analyzing the scope of liability under Section 10(b) for persons other than those who "use or employ" misstatements "in connection with" the purchase or sale of a security. See *In re Miller*, 276 F.3d 424, 429 (8th Cir. 2002) (control person provisions "exten[d] liability well beyond traditional doctrines" of agency and respondeat superior). Courts have routinely applied these provisions to impose liability on corporations and individuals. *E.g.*, *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 70, 74-76 (2d Cir. 2001). Extending liability beyond the line Congress carefully drew would be inconsistent with its intent, as this Court recognized in *Central Bank*. See 511 U.S. at 184 ("[t]he fact that Congress chose to impose some forms of secondary liability, but not others, indicates a deliberate congressional choice with which the courts should not interfere"); Fischel, *supra*, 69 CAL. L. REV. at 94 n.83 (broader theories of secondary liability would make control person provisions "surplusage").

D. Extensive Judicial Lawmaking Would Be Needed To Address The Clear Incompatibility Between Scheme Liability And Existing Standards For Section 10(b) Damages Actions.

Plaintiff's claim—and private scheme liability in general—do not "fit" existing Section 10(b) requirements of materiality or loss causation any more than they fit reliance standards. Each of these elements would have to be recast before it could be satisfied in "scheme" suits, necessitating the sort of judicial lawmaking this Court eschews.

Materiality. A Section 10(b) plaintiff must prove that the defendant's misstatement concerned facts material to the plaintiff's decision to purchase or sell securities. *TSC Indus.* v. *Northway, Inc.*, 426 U.S. 438 (1976). The materiality test thus looks to the importance of the alleged false information communicated to the plaintiff or the market. In the scheme liability context, where the alleged misstatement is not communicated to either, there is a mismatch between the alleged wrongdoing and materiality analysis. Indeed, the only allegations of materiality here relate to *Charter's* misstatements (*e.g.*, AC ¶ 8, SAC ¶ 127), and plaintiff did not allege that the Vendors' alleged deceptive conduct was material.

The absence of such an allegation is understandable. In contrast to the $487 million inflation of cash flow for 2000 and 2001 alleged by plaintiff to have resulted from Charter's fraud (AC ¶ 15) and to Charter's $7 billion loss of market value upon revelation of its fraud, plaintiff claims that Charter's improper accounting for the transactions with the Vendors inflated operating cash flow for one quarter by only $17 million, *i.e.*, 3.5% of the total inflation alleged. *Supra*, p. 8. Plaintiff does not allege that the Vendors acted in concert, so the alleged impact of each of their individual transactions was considerably less. As a "rule of thumb" a deviation of less than 5% "is unlikely to be material." *SEC Staff Accounting Bulletin No. 99—Materiality* 2 n.2 (Aug. 12, 1999); see *Higginbotham* v. *Baxter Int'l*, 2007 WL 2142298, at *5 & n. (7th Cir. July 27, 2007) (Easterbrook, J.).

If the Court recognized scheme liability, it would have to determine how materiality would be assessed with respect to such claims. Would the Court adopt a new standard under which the secondary actor's liability turns upon the materiality of the issuer's statement, no matter how small the scheme liability defendant's contribution to the issuer's misstatement? Or would liability turn on the materiality of the scheme liability defendant's misstatements? That too would require creation of a new standard—breaking the link be-

tween the materiality assessment and the statement communicated to investors. Under this approach, materiality would turn on a statement *not* communicated to investors. And a defendant in the position of the Vendors would not know whether its statement was material in light of the issuer's financial situation. Either way, materiality law would have to be revised totally if scheme claims were to be viable.

Loss causation. A private plaintiff must also plead that "the act or omission of the defendant" "caused the plaintiff's economic loss." 15 U.S.C. § 78u-4(b)(4); *Dura Pharms.* v. *Broudo*, 544 U.S. 336, 346 (2005). In *Dura*, this Court held the complaint insufficient because it did not allege "what the causal connection might be between [plaintiff's] loss and the misrepresentation[s]." *Id.* at 347. Plaintiff here could not establish any such causal connection. To do so it would have to demonstrate the effect of each Vendor's alleged conduct on the market—separate from the effect of myriad false statements in Charter's financial reports. See *Lentell* v. *Merrill Lynch & Co.*, 396 F.3d 161, 174-177 (2d Cir. 2005). Because Charter's financial statements falsely described a multitude of facts of far greater magnitude, and did not separately inform the market of the Vendor transactions, there is no method for segregating the impact of Charter's accounting for the Vendor transactions from "the tangle of factors affecting price." *Dura*, 544 U.S. at 343. If "scheme" liability were created, the judiciary would also have to create entirely new standards for loss causation.

Reliance. As we have discussed, existing reliance requirements do not fit scheme liability because the defendant's statements are not communicated to the market or to individual investors. To the extent that incompatibility does not preclude scheme liability claims, it would require courts to invent new reliance standards to apply to such claims.

The content of all of these new standards would be highly controversial because class action claimants could impose

enormous damages against suppliers of goods, services, or financing that had only minor roles in an alleged scheme. Under Exchange Act § 21D(f)(2) a defendant found to have "knowingly committed a violation of the securities laws" may potentially be held jointly and severally liable for the entire loss resulting from the fraud. Secondary actors could face billions of dollars in damages if they were found liable on a scheme theory. See p. 8, *supra*; *In re Fannie Mae Sec. Litig.*, MDL No. 1668 (D.D.C. Aug. 12, 2006), 2d Am. Consol. Class Action Compl. (seeking to hold bank jointly and severally liable for alleged loss of $12 billion resulting from Fannie Mae's false financial statement, where bank allegedly participated in only two transactions that Fannie Mae misused to shift $107 million in revenue to future quarters).[12]

Creating new standards would require extensive judicial lawmaking. If the Court today confronted the question whether to imply a private cause of action under Section 10(b), it would decline to do so. See *Alexander*, 532 U.S. at 289 (statutes like Section 10(b) that "focus on the person regulated rather than the individuals protected" imply no intent to create a private right of action); *Transamerica Mortgage* v. *Lewis*, 444 U.S. 11, 19-20 (1979) (declining to imply private right of action to enforce the antifraud provision of

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[12] Plaintiff contends that the PSLRA's proportionate liability provision shows Congress contemplated broad secondary liability. Pet. Br. 22; 15 U.S.C. § 78u-4(f). But Congress's goal in that provision was to address "the chilling effect of unlimited [damages] exposure" on defendants subject to primary liability, such as auditors, underwriters, and directors. H.R. Conf. Rep. No. 104-369, at 38 (1995). Having refused to overturn *Central Bank*, Congress had no reason to contemplate secondary liability in private actions. The scheme liability theory had not yet been invented. Under plaintiff's new "purpose and effect" standard a secondary actor found liable would always have the "knowledge" needed to trigger joint and several liability, guaranteeing grossly disproportionate damages in virtually all cases.

the Investment Advisers Act because that provision "simply proscribes certain conduct, and does not in terms create or alter any civil liabilities," and Congress had provided for enforcement by the SEC—both also true of Section 10(b)).

The fact that a private cause of action would not now be implied strongly suggests that "a court must be chary of reading" it expansively by inventing a broad new theory of scheme liability. *Transamerica*, 444 U.S. at 19.[13] The Court recently has recognized that the very concerns about the judicial role that preclude creation by courts of new causes of action also weigh strongly against judicial resolution of complex and contentious policy choices involved in broadly extending an implied cause of action. *Wilkie* v. *Robbins*, 127 S. Ct. 2588, 2597, 2601, 2604 (2007) (declining to imply "a new *Bivens* damages action"; the "difficulty in defining a workable cause of action" meant an implied "cure would be worse than the disease"); see also *id.* at 2608 ("'the heady days in which this Court assumed common-law powers to create causes of action'" are over; existing implied actions should be limited "'to the precise circumstances that they involved'") (Thomas & Scalia, JJ., concurring); *Virginia Bankshares* v. *Sandberg*, 501 U.S. 1083, 1103-1106 (1991); *id.* at 1110 (Scalia, J., concurring).

Determining how the Section 10(b) action should be revised to fit a scheme liability claim is a quintessentially legislative task—one Congress would resolve through trade-offs and compromises—and is unsuited to federal courts "that have not been vested with open-ended lawmaking powers." *Northwest Airlines* v. *Transport Workers*, 451 U.S. 77, 95 (1981); see also *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 579 (1979) (refusing to "legislate" an implied cause of

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[13] The Court does not defer to the SEC's views on "whether a cause of action should be implied by judicial interpretation." *Piper* v. *Chris-Craft Indus.*, 430 U.S. 1, 41 n.27 (1977). See also *Central Bank*, 511 U.S. at 188-191; *Lampf*, 501 U.S. at 361.

action under Exchange Act § 17(a); "'[I]t is not for us to fill any *hiatus* Congress has left in this area'").[14]

E. Scheme Liability Would Overturn *Central Bank*.

Theories of Section 10(b) liability closely resembling plaintiff's scheme theory were routinely invoked to challenge conduct *as aiding and abetting* before *Central Bank*. *E.g.*, *Feldman* v. *Pioneer Petroleum*, 813 F.2d 296, 301 (10th Cir. 1987) (bank "aided and abetted in a conspiracy to promote the scheme" by engaging in a "deceptive transaction to create the false appearance to prospective investors" that a company would obtain loans from the bank); *SEC* v. *Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974) (an "aider and abettor" has "general awareness that his role was part of an overall activity that is improper" and "knowingly and substantially assisted the violation"). Scheme liability was a subspecies of aiding and abetting, not an alternative theory of primary liability.

Central Bank would have been decided differently if involvement in a "scheme" were a proper basis for liability. See 511 U.S. at 200 n.12 (Stevens, J., dissenting) ("conspiracy" claims are now barred). Central Bank was the indenture trustee for a bond issue. It was obliged to ensure compliance with a covenant that the land securing the bonds had an appraised value exceeding the outstanding principal and interest. An indenture trustee (unlike the Vendors here) is a "watchdog" responsible for the protection of the issuer's pub-

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[14] These issues did not arise in pre-*Central Bank* aiding and abetting cases because aiding and abetting liability is by definition derivative of the primary violator's liability. But *Central Bank* requires plaintiff to argue that scheme liability is a form of primary violation; in that context, relying on another violator's conduct to satisfy these elements of the cause of action makes no sense. Indeed, such an approach would confirm that scheme liability is simply another label for aiding and abetting. Courts therefore would have to craft new rules to identify when a scheme liability defendant's actions satisfy each element.

lic investors and its identity is known to investors. See Brief for the U.S., No. 92-854, at 2-3 (May 12, 1992). Central Bank was informed that the issuer's appraisal was grossly inflated. *Id.* at 2. Initially, it ordered a new appraisal, but after meeting with the issuer it secretly "agreed to defer the review" until after the bonds were sold. *Ibid.* The bonds were then "marketed through a fraudulently false and misleading disclosure document" that represented the "appraisal as being correct," and they were soon in default. *Id.* at 3.

As described by the district court in *Central Bank*, plaintiff bond purchasers alleged that the trustee "took affirmative steps to postpone review of the * * * appraisal, a key element in the alleged scheme to defraud." Pet. for Cert., *Central Bank*, No. 92-854, Pet. App. A33. By the trustee's "affirmative action" in agreeing to the delay, it "provided 'substantial assistance' to the fraudulent scheme." Brief for the U.S., *supra*, at 4, 5 n.2; see 511 U.S. at 168-169. There is no doubt that by knowingly accepting a flawed appraisal and certification and halting a new appraisal that would have revealed the inadequacy of the collateral, the trustee would have satisfied plaintiff's test for a primary violation of Section 10(b). The trustee's acts could readily be characterized as a deceptive device that had the "purpose and effect" of creating a false appearance that the appraisal was reliable, which was the *sine qua non* of the fraudulent scheme to sell the bonds.

A test that would convert the aider and abettor in *Central Bank* into a primary violator cannot be correct. Plaintiff's scheme liability theory would make *Central Bank* a dead letter: every peripheral participant would be a primary violator and no one an aider and abettor. Because Congress has ratified *Central Bank* in Section 20(e), that result would frustrate and subvert Congress's informed policy decision.

II. PLAINTIFF'S ARGUMENTS IN FAVOR OF SCHEME LIABILITY ARE MERITLESS.

A. The Vendors Would Not Be Liable At Common Law.

Plaintiff's scheme liability theory receives no support from the common law of deceit. This Court has repeatedly declined to use common law tort standards to define the scope of the implied private action. See *Central Bank*, 511 U.S. at 178, 184 ("[e]ven assuming" a "deeply rooted background of aiding and abetting tort liability, it does not follow that Congress intended to apply that kind of liability to the private causes of action in the securities Acts"); *Blue Chip Stamps*, 421 U.S. at 744-745 (tort law is "light years away from the world of commercial transactions to which Rule 10b-5 is applicable").

Beyond this, the Vendors would not have been liable for deceit in 1934 when Section 10(b) was passed. To be sure, the common law did reach misrepresentations by conduct amounting to an assertion—such as turning back a car's odometer. But key elements of a deceit action are missing here. The complaint does not allege that the Vendors made a misrepresentation to plaintiff, or intended a misrepresentation to reach plaintiff, or owed a duty to disclose to plaintiff, or that plaintiff relied on or was even aware of a misrepresentation by the Vendors.

First, the complaint does not allege that the Vendors—who dealt only with Charter—addressed a misrepresentation to plaintiff. At common law, a corporate insider who issued a fraudulent prospectus to initial stock purchasers was not liable to investors in the secondary market who obtained and relied upon the prospectus.[15] The Restatement adopted this

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[15] *Peek* v. *Gurney*, (1873) L.R. 6 H.L. 377; see *Van Swall* v. *Derschug*, 257 N.Y.S. 206, 207 (App. Div. 1932) (scheme allegations irrelevant because misrepresentations were not addressed to plaintiff); *Greenville Nat'l Bank* v. *National Hardwood Co.*, 217 N.W.

rule, confining liability "to the class to whom the representations are addressed." RESTATEMENT OF TORTS § 531 cmt. d (1938) ("RESTATEMENT"). Plaintiff does not allege that the Vendors addressed any representations to Charter investors.

Second, plaintiff does not allege that the Vendors intended to have Charter convey misrepresentations to investors in order to cause them to buy Charter stock. See RESTATEMENT § 533; compare AC ¶ 196; SAC ¶¶ 10-11, 109, 221. Common law cases required that a misrepresentation be made for the *purpose* of inducing reliance, not merely with *knowledge* that reliance was likely.[16] The Restatement provided that knowledge could support deceit liability generally (§ 531 cmt. a), but it preserved the higher "purpose" standard to limit the scope of liability when—as here—the alleged misrepresentation is relayed to third parties (§ 533). Thus, the maker of a misrepresentation is not liable if he merely "knows that its recipient * * * will to a substantial certainty, repeat it to a third person for the purpose of influencing his conduct" (§ 533 cmt. b).

Finally, the complaint does not allege reliance. The common law required plaintiffs to show "justifiable reliance upon the misrepresentation" in the "type of transaction in which the maker intended to influence their conduct." RESTATEMENT §§ 525, 531. But plaintiff has not alleged that it even knew about the Vendors' advertising transactions with

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786, 786 (Mich. 1928) (no "direct connection between those who claim to have been deceived and those who made the false representations"); Harry Shulman, *Civil Liability and the Securities Act*, 43 YALE L.J. 227, 239 & n.46 (1933) (citing cases).

[16] *E.g.*, *Dinsmore* v. *National Hardwood Co.*, 208 N.W. 701 (Mich. 1926) (citing cases); *Gillespie* v. *Hunt*, 119 A. 815, 817 (Pa. 1923); *Webb* v. *Rockefeller*, 93 S.W. 772, 776 (Mo. 1906); *Hunnewell* v. *Duxbury*, 28 N.E. 267, 268 (Mass. 1891); W. Page Keeton, *The Ambit of a Fraudulent Representor's Responsibility*, 17 TEX. L. REV. 1, 9 (1938).

Charter, much less that it relied on the Vendors' alleged acts when it traded Charter stock. See *supra*, pp. 17-18.[17]

B. Rule 10b-5(a) And (c) Do Not Expand The Scope Of The Section 10(b) Cause Of Action.

Plaintiff argues (at 24) that Section 10(b) must be read to prohibit conduct beyond the making of false statements or misleading omissions in order to give meaning to clauses (a) and (c) of Rule 10b-5. This Court has made clear, however, that Rule 10b-5 does not expand the coverage of Section 10(b). See *Central Bank*, 511 U.S. at 173 (a "private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b)"); *Hochfelder*, 425 U.S. at 214 (the "scope [of Rule 10b-5] cannot exceed the power granted the Commission by Congress under § 10(b)").

This Court's decisions concluding that clauses (a) and (c) cover frauds not involving statements do not help plaintiff. Those subsections reach silence and deceptive conduct when there is a violation of a duty truthfully to disclose. *Zandford*, 535 U.S. at 819, 821, 823; *Chiarella*, 445 U.S. at 225 n.5, 230; *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153 (1972). They also reach market manipulation. But plaintiff's scheme allegations do not fit these categories.

Nor does plaintiff's claim bear any resemblance to the situation Rule 10b-5 was intended to address. In 1942, the SEC learned that a corporation's president falsely told shareholders that the corporation was losing money and purchased their shares based on the resulting depressed prices. *Hochfelder*, 425 U.S. at 212 n.32. Existing rules against fraud in purchasing securities applied only to brokers and dealers. To close this loophole, the SEC copied a prohibition on fraud in Section 17(a) of the 1933 Act, modified it to in-

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[17] See *Dinsmore*, 208 N.W. at 702 (unless prospective purchaser "knows and relies upon [misrepresentations] when he purchases, it cannot be advanced that he was in any way influenced by them").

clude purchases, and adopted it as a rule pursuant to Section 10(b). *Ibid.*; see 15 U.S.C. § 77q(a). The rule was never intended to police commercial sales agreements.

Plaintiff nevertheless contends that the rule's "scheme" reference drawn from Section 17(a) should be read broadly to cover the Vendors' alleged conduct. But Section 17(a) does not create a private cause of action for fraudulent schemes, and its language differs from that of Section 10(b). As this Court has held repeatedly, "[l]iability under Rule 10b-5 * * * does not extend beyond conduct encompassed by § 10(b)'s prohibition." *O'Hagan*, 521 U.S. at 651. Because plaintiff's allegations do not satisfy the requirements for Section 10(b) liability (*supra*, Part I), Rule 10b-5's scheme language cannot provide a basis for liability here.

C. This Court Has Rejected Broad Interpretations Of Section 10(b) That Exceed Its Language.

Plaintiff cites (Br. 29-31) decisions stating that Section 10(b) and Rule 10b-5 should be construed broadly and flexibly to further their remedial purposes. But this Court has rejected such justifications for reading the securities laws expansively, focusing instead on the statutory text and refusing to broaden the implied private action. See *Central Bank*, 511 U.S. at 188 ("[p]olicy considerations cannot override our interpretation of the text and structure of the Act"); *Hochfelder*, 425 U.S. at 198-200, 218 n.33; *Blue Chip Stamps*, 421 U.S. at 739-744, 747-749; see also *Board of Governors* v. *Dimension Fin. Corp.*, 474 U.S. 361, 373-374 (1986) (discussing problems with applying broad legislative purposes at expense of specific provisions).

Plaintiff also misreads this Court's decisions. In *Superintendent of Insurance* v. *Bankers Life*, 404 U.S. 6, 7-12 (1971), the Court held that the plaintiff company stated a claim against new controlling stockholders and directors who allegedly "duped" the company by liquidating securities and stealing the proceeds without disclosure. The Court did not

rule on whether "outside collaborators," including banks that had handled the transactions and the company's former owner, could be liable for the fraud. *Id.* at 10, 13.

Herman & MacLean v. *Huddleston*, 459 U.S. 375 (1983), does not extend Section 10(b) to reach a person who causes a misrepresentation to be made that is not attributed to that person. The passage plaintiff cites (at 30) simply points out that an accountant could not be sued under Section 11 for a misrepresentation in a registration statement that it had not "prepared or certified," while "any person" who "participat[ed] in the registration statement" and met the other statutory requirements might be sued under Section 10(b). *Id.* at 386 n.22. Plaintiff has not alleged that the Vendors participated in preparing Charter's financial statements, and its claim does not meet the essential requirements of Section 10(b).

In *Wharf (Holdings) Ltd.* v. *United Int'l Holdings, Inc.*, 532 U.S. 588 (2001) (cited by plaintiff at 30-31), this Court held that Wharf's secret intent not to honor an option it sold to an investor was a misrepresentation, because "a promise necessarily carries with it the implied assertion of an intention to perform." *Id.* at 596 (quoting RESTATEMENT (SECOND) OF TORTS § 530 cmt. c (1976)). In this case, the Vendors made no assertions whatsoever to plaintiff. Accordingly, this Court's precedents do not support plaintiff's claim.

III. BROAD SCHEME LIABILITY FOR SECONDARY ACTORS WOULD HARM U.S. SECURITIES MARKETS AND IS UNNECESSARY TO DETER MISCONDUCT OR COMPENSATE INVESTORS.

Ultimately, plaintiff and its *amici* maintain that scheme liability is necessary to deter fraud and protect the integrity of the capital markets. Even if correct, that contention could not carry the day; "[p]olicy considerations cannot override" the "text and structure of the Act." *Central Bank*, 511 U.S. at 188. But plaintiff's argument is wrong on its own terms: scheme liability would *undermine* securities markets, *dam-*

age the economy, and *injure* investors, while doing nothing to deter fraud. Insofar as "practical factors" are relevant (*Blue Chip Stamps*, 421 U.S. at 749), "the inexorable broadening" of liability would "result in more harm than good." *Id.* at 747-748. These practical considerations show, as in *Central Bank*, that any decision to expand liability to new classes of defendants should be left to Congress.

A. Scheme Liability Would Encourage Wasteful And Meritless Litigation, Damaging The Economy.

1. There is no doubt that "[p]rivate securities fraud actions, * * * if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law." *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2504 (2007). The Court has noted "that 'litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general. * * * Even weak cases brought under the Rule may have substantial settlement value'" because "'[t]he very pendency of the lawsuit may frustrate or delay normal business activity.'" *Dabit*, 547 U.S. at 80. Opportunities for abusive discovery, often described as a kind of "financial blood letting" (Kassis, *The Private Securities Litigation Reform Act*, 26 SETON HALL LEGIS. J. 119, 124 (2001)), "may likewise exist in this type of case to a greater extent than they do in other litigation." *Blue Chip Stamps*, 421 U.S. at 741.

The costly disruption caused by a securities fraud suit thus "represent[s] an *in terrorem* increment of the settlement value" that gives even an insubstantial complaint "a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Blue Chip Stamps*, 421 U.S. at 740-741. This effect is so pronounced that defendants settle virtually *every* securities fraud claim that survives a motion to dismiss. See Br. for the United States as Amicus Curiae at 22, *Tellabs, Inc.* v. *Makor Issues & Rights*, No. 06-484 (Feb.

9, 2007) ("practical reality" is that if a securities case is not dismissed it "will never reach an adjudication on the merits"). That reality denies defendants an opportunity to contest the merits and encourages plaintiffs to bring meritless suits.

2. These harms to the economy would be aggravated by scheme liability. Scheme litigation would greatly expand the categories of targeted defendants, permitting suit against limitless numbers of counter-parties with no direct connection to market activity. Such defendants would be "prime targets of abusive securities lawsuits" because "[t]he deeper the pocket, the greater the likelihood that a marginal party will be named as a defendant." S. Rep. No. 104-98, at 9 (1995). To protect themselves, defendants would be forced to plead in all other potential secondary actors, even if plaintiffs did not.

Recognizing scheme liability would also greatly expand the range of transactions that could give rise to suit. Innumerable legitimate business arrangements—for example, those involving derivatives, swaps, or barter exchanges—are governed by complex and sometimes ambiguous accounting rules. See p. 6 & n.5, *supra*. Plaintiffs would have little difficulty drafting complaints that portray them as improper.

The problem is compounded by the characteristics of scheme litigation. A rule that hinges liability on "purpose and effect" would raise factual disputes in every case, making it uniquely difficult for innocent defendants to obtain an early dismissal—and thus to escape coerced settlement. The availability of joint and several liability, meanwhile, would place scheme defendants at risk of enormous damages out of proportion to the actor's involvement in the alleged wrongdoing. This combination of dismissal-proof allegations and disproportionate liability means that, when "peripheral defendants are sued, the pressure to settle [will be] overwhelming." S. Rep. No. 104-98, at 21. See *Central Bank*, 511 U.S. at 189.

If history and common sense are guides, these factors—a vast array of new defendants, astronomical potential liability,

and a nebulous liability standard—mean scheme liability would "'allow a relatively high proportion'" of "'bad'" cases into court. "'The risk of strike suits is particularly high in such cases.'" *Blue Chip Stamps*, 421 U.S. at 742. As Justice Powell noted in similar circumstances, "[a] rule allowing this type of open-ended litigation would itself be an invitation to fraud." *Id.* at 761 (Powell, J., concurring). "'The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.'" *Id.* at 748.

3. Scheme liability would harm investors. One obvious component of this injury would be the direct costs of litigation imposed upon shareholders of companies that are swept up in scheme allegations. The "enormous size of [coerced] settlement values" is well known. INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 74 (rev. Dec. 5, 2006) ("INTERIM REPORT"), *available at* http://tinyurl.com/yqdy8n. Other direct costs could be even more substantial. The best empirical data, studying settlements in almost 500 post-PSLRA suits, found that the mere filing of securities fraud litigation caused $25 billion in shareholder wealth to be "wiped out just due to litigation" in the actions studied. THAKOR, THE UNINTENDED CONSEQUENCES OF SECURITIES LITIGATION 14 (U.S. Chamber of Commerce Institute for Legal Reform 2005), *available at* http://tinyurl.com/2vz397.

These direct costs are only the tip of the iceberg. The litigation risks posed by scheme liability would have "ripple effects" throughout the economy. *Central Bank*, 511 U.S. at 189. A rule that threatens to impose staggering liability on a supplier whose transactions are misstated by an issuer would make it less attractive to do business with the most innovative and entrepreneurial companies, whose volatile share prices invite litigation; would make small deals with large companies unattractive because (as in this case) the tradeoff for a small profit could be liability for huge market losses; and would lead suppliers to build a risk premium into their

prices, to the ultimate detriment of investors and consumers and to the benefit of foreign competitors.

Scheme liability also would threaten the professionals whose services are essential to capital formation, causing all to raise prices and some to decline higher-risk engagements. See S. Rep. No. 104-98, at 9, 21-22. The difficulty of obtaining high-quality professional services would fall on "newer and smaller companies," as "business failure would generate securities litigation against the professional, among others." *Central Bank*, 511 U.S. at 189. This would "ad[d] significantly to the cost of raising capital" (S. Rep. No. 104-98, at 9), causing injury to "'the entire U.S. economy.'" *Dabit*, 547 U.S. at 81.

Vague liability rules also worsen the competitive position of American markets. Bipartisan studies have found that "the United States is losing its leading competitive position" compared to markets abroad, in large part due to escalating "liability risks." INTERIM REPORT at ix-x, 2-3, 29-34; accord BLOOMBERG & SCHUMER, SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP ii, 5, 12 (Dec. 2006), *available at* http://tinyurl.com/2fhyuf. "Foreign companies commonly cite the U.S. class action enforcement system as the most important reason why they do not want to list in the U.S. market." INTERIM REPORT at 11, 71. Insurance costs for Fortune 500 companies are six times higher here than in Europe. *Id.* at 71. Given the importance of "certainty and predictability" in this area (*Central Bank*, 511 U.S. at 188), vague theories of scheme liability could only exacerbate these disparities. See *Hearing of the House Financial Services Committee on the State of the International Financial Services System* (June 20, 2007) (the lack of "clear lines" for "primary liability" is "a risk to our economy, to our competitiveness, to jobs") (testimony of Treasury Secretary Henry Paulson).

B. Scheme Liability Is Not Necessary To Deter Fraud Or Compensate Investors.

Plaintiff and its *amici* maintain that the harms that would be imposed by scheme liability must be endured in the interest of deterring fraud. This assertion is wrong. Private civil liability is not necessary to combat wrongdoing by secondary actors—and would not be effective in doing so.

1. Deterrence of misconduct in the securities markets is accomplished principally by *public* enforcement. In fact, "[t]he United States has the toughest administrative enforcement of securities laws in the world." INTERIM REPORT at 71. The lead role in this regard, of course, is taken by the SEC, which employs a broad range of statutory and administrative tools to combat fraud. As we have explained, Congress enacted Exchange Act § 20(e) specifically to authorize civil actions by the SEC against aiders and abettors. Because the SEC is not required to establish reliance or causation, its actions will be much more effective than private litigants' "scheme" claims. In addition, the SEC may obtain injunctive relief, administrative orders against aiders and abettors, orders barring or suspending individuals from serving as an officer or director of an issuer of securities, and large civil penalties, including disgorgement of any gain. See 15 U.S.C. §§ 78u, 78u-3; 4 BROMBERG & LOWENFELS § 7:307, at 7-503. The Commission also may invoke other statutory bases for relief against secondary actors, such as Section 17(a)(3) of the Securities Act, 15 U.S.C. § 77q(a)(3) (proscribing fraudulent "transaction, practice, or course of business").

The SEC has not been shy in using these powers. During 2006, the Commission's 900-person enforcement staff initiated over 900 investigations, brought 218 suits and 356 administrative proceedings, and obtained orders requiring payment of more than $3.3 billion in disgorgement and penalties. SEC 2006 Performance and Accountability Report at 8, *available at* http://tinyurl.com/ygyfv8. Of particular im-

portance, Congress in 2002 authorized the Commission to combine civil penalties and disgorgements into a "Fair Fund" to provide compensation to defrauded investors. 15 U.S.C. § 7246. In total, the Commission has recovered more than $8 billion for investors since receiving this authority. SEC 2006 Performance and Accountability Report at 23. See Greg Stohr, *Bush Administration Rebuffs Investors at High Court*, Bloomberg (June 12, 2007) ("We think the SEC is the right entity to bring those lawsuits," quoting Allan Hubbard, director of the Administration's National Economic Council).

In addition, securities fraud is a criminal violation punishable by fines and imprisonment. See, *e.g.*, 15 U.S.C. § 78ff. The Department of Justice, assisted by the FBI, enforces these laws aggressively: its Corporate Fraud Task Force has obtained more than 1200 guilty pleas and convictions since July 2002, and more than $1 billion in forfeitures used to compensate investors. Department of Justice, Fact Sheet: President's Corporate Fraud Task Force (July 17, 2007), *available at* http://tinyurl.com/37hudk. These federal efforts are supplemented by state prosecutors who have been vigorous in challenging fraud. See, *e.g.*, http://oag.state.ny.us/press/agpress04.html (New York Attorney General obtained more than $1 billion in settlements in 2004 alone). These enforcement mechanisms are far-reaching and effective and are the real deterrent to fraud by corporate officials.

2. Public enforcement actions effectively serve the goals of deterrence and compensation. Private class actions do not. *First*, "the deterrent effect [of class actions] is weak" when "the merits of claims" are "irrelevant to their initiation or settlement values." Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 952 (1993).[18] When

[18] The principal predictors of whether suit will be brought and the size of the ultimate settlement are declines in stock price and the amount of the defendant's insurance coverage. Garry *et al.*, *The*

all cases that survive a motion to dismiss are settled, litigation and settlement costs become costs of doing business, not a sign of wrongdoing. And any deterrent effect is vitiated by the most salient characteristic of the securities fraud class action: penalties fall not on individual wrongdoers but "on the corporation and its insurer, which means that they are ultimately borne by the shareholders." INTERIM REPORT at 78.

Second, these damages provide no real compensation to investors. The average securities fraud suit settles for two to three percent of investors' alleged losses, with one-third of that skimmed off the top by plaintiffs' counsel and defense costs (absorbed by current shareholders) usually amounting to another 25 to 35 percent of the settlement value. Coffee, *Reforming the Securities Class Action*, 106 COLUM. L. REV. 1534, 1545-1546 (2006). If one adds the "costs of D&O insurance and business disruption, it is not clear that there is *any* positive recovery." INTERIM REPORT at 79 (emphasis added). See Coffee, *supra*, 106 COLUM. L. REV. at 1559.

Third, even this overstates the value of class action recoveries. Forty years ago, Judge Friendly expressed the concern that expansive securities fraud liability "'will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers.'" *Blue Chip Stamps*, 421 U.S. at 739 (quoting *SEC* v. *Texas Gulf Sulphur*, 401 F.2d 833, 867 (2d Cir. 1968)). That warning has proved accurate. Virtually all commentators now recognize that, over time, a diversified investor buys and sells in roughly equal amounts, meaning that securities fraud settlements simply "transfe[r] money from one pocket to the other, with about half of it dropping on the floor for lawyers to pick

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Irrationality of Shareholder Class Action Lawsuits: A Proposal for Reform, 49 S.D. L. REV. 275, 287 n.98 (2004) (citing studies). However useful in individual cases, the PSLRA has not solved this systemic problem. Settlement costs are now at an all-time high. See BLOOMBERG & SCHUMER, at 74.

up." Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1503 (1996).[19]

In such a regime, securities fraud litigation serves only as "a grotesquely inefficient form of insurance against large stock market losses." Alexander, *Do the Merits Matter?*, 43 STAN. L. REV. 497, 501 (1991). And that already grotesque inefficiency would carry an especially harmful consequence in the context of scheme liability: *plaintiff here would have the Vendors' innocent shareholders compensate Charter's shareholders for a fraud committed by Charter's own management.* See *Piper* v. *Chris-Craft Indus.*, 430 U.S. 1, 39 (1977) (refusing to imply a cause of action where "shareholders" would bear "the burden of any judgment" and damages would benefit "the very party whose activities Congress intended to curb"). That outcome would pervert the purposes of Section 10(b) and Rule 10b-5, which manifestly were not intended "to provide investors with broad insurance against market losses." *Dura*, 544 U.S. at 345. As in *Central Bank*, plaintiff's attempt here to vastly expand the scope of private securities fraud liability would "disserve the goals of fair dealing and efficiency in the securities markets." 511 U.S. at 188. It should be rejected.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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[19] As a result, "recoveries from class action litigation represent a windfall to large investors." Alexander, *supra*, 48 STAN. L. REV. at 1502. See INTERIM REPORT at 79; EASTERBROOK & FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 339-340 (1991). In contrast, "small undiversified investors are seldom likely to receive a monetary benefit from the securities class action" because "buy and hold" investors are "more likely to have purchased * * * stock before the class period commenced." Coffee, 106 COLUM. L. REV. at 1559-1560. Thus "securities litigation systematically may transfer wealth from buy and hold investors to more actively trading investors." INTERIM REPORT at 80.

Respectfully submitted.

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STATUTORY AND REGULATORY ADDENDUM

1. Section 10(b) and Rule 10b-5

Securities Exchange Act § 10, 15 U.S.C. § 78j.
Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * *

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17 C.F.R. § 240.10b-5.
Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make

the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

2. Control person provisions

Securities Exchange Act § 20, 15 U.S.C. § 78t. Liability of controlling persons and persons who aid and abet violations.

(a) Joint and several liability; good faith defense

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

* * *

(e) Prosecution of persons who aid and abet violations

For purposes of any action brought by the Commission under paragraph (1) or (3) of section 78u(d) of this title [15 U.S.C. § 78u(d)(1) or (3)], any person that knowingly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.

Securities Act § 2, 15 U.S.C. § 77b.
Definitions; promotion of efficiency, competition, and capital formation.

(a) Definitions

* * *

(11) * * * As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

17 C.F.R. § 240.12b-2.
Definitions.

* * *

Control. The term "control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

3. Loss causation and proportionate liability provisions

Securities Exchange Act § 21D, 15 U.S.C. § 78u-4. Private securities litigation.

* * *

(b) Requirements for securities fraud actions

* * *

(4) Loss causation

In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.

* * *

(f) Proportionate liability

(1) Applicability

Nothing in this subsection shall be construed to create, affect, or in any manner modify, the standard for liability associated with any action arising under the securities laws.

(2) Liability for damages

(A) Joint and several liability. Any covered person against whom a final judgment is entered in a private action shall be liable for damages jointly and severally only if the trier of fact specifically determines that such covered person knowingly committed a violation of the securities laws.

* * *

4. Fair funds provision

Sarbanes-Oxley Act § 308, 15 U.S.C. § 7246.
Fair funds for investors.

(a) Civil penalties added to disgorgement funds for the relief of victims

If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 78c(a)(47) of this title) the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.

* * *

5. Other antifraud provisions

Securities Act § 11, 15 U.S.C. § 77k.
Civil liabilities on account of false registration statement.

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement, in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

* * *

Securities Act § 12, 15 U.S.C. § 77*l*.
Civil liabilities arising in connection with prospectuses and communications.

(a) In general. Any person who—

(1) offers or sells a security in violation of section 5 [15 U.S.C. § 77e], or

(2) offers or sells a security (whether or not exempted by the provisions of section 3 [15 U.S.C. § 77c], other than paragraphs (2) and (14) of subsection (a) thereof), by the use of any means or instruments of transportation or

communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable, subject to subsection (b), to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

(b) Loss causation

In an action described in subsection (a)(2), if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.

Securities Act § 17, 15 U.S.C. § 77q.
Fraudulent interstate transactions.

(a) Use of interstate commerce for purpose of fraud or deceit

It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as de-

fined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

* * *

Securities Exchange Act § 9, 15 U.S.C. § 78i.
Manipulation of security prices.

(a) Transactions relating to purchase or sale of security

It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—

(1) For the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or a false or misleading appearance with respect to the market for any such security, (A) to effect any transaction in such security which involves no change in the beneficial ownership thereof, or (B) to enter an order or orders for the purchase of such security with the

knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties, or (C) to enter any order or orders for the sale of any such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange or in connection with any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) with respect to such security creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

(3) If a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) with respect to such security, to induce the purchase or sale of any security registered on a national securities exchange or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) with respect to such security by the circulation or dissemination in the ordinary course of business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations of any one or more persons conducted for the purpose of raising or depressing the price of such security.

(4) If a dealer or broker, or the person selling or offering for sale or purchasing or offering to purchase the security or a security-based swap agreement (as defined in section

206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) with respect to such security, to make, regarding any security registered on a national securities exchange or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) with respect to such security, for the purpose of inducing the purchase or sale of such security or such security-based swap agreement, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.

(5) For a consideration, received directly or indirectly from a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) with respect to such security, to induce the purchase of any security registered on a national securities exchange or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 U.S.C. § 78c note]) with respect to such security by the circulation or dissemination of information to the effect that the price of any such security will or is likely to rise or fall because of the market operations of any one or more persons conducted for the purpose of raising or depressing the price of such security.

(6) To effect either alone or with one or more other persons any series of transactions for the purchase and/or sale of any security registered on a national securities exchange for the purpose of pegging, fixing, or stabilizing the price of such security in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

* * *

(e) Persons liable; suits at law or in equity

Any person who willfully participates in any act or transaction in violation of subsections (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant. Every person who becomes liable to make any payment under this subsection may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment. No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.

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Securities Exchange Act § 18, 15 U.S.C. § 78r.
Liability for misleading statements.

(a) Persons liable; persons entitled to recover; defense of good faith; suit at law or in equity; costs, etc.

Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder, or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title [15 U.S.C. § 78o(d)], which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any

person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.